

ZTE (763 HK)

CMBI Tech Corporate Day takeaways

We invited ZTE mgmt. to CMBI Tech Corporate Day and the meeting mainly focused on ZTE's business outlook, 3rd batch of China 5G BTS tenders and demand recovery of overseas market. We maintain positive on ZTE as we believe ZTE will be the major beneficiary of global 5G deployment and industry consolidation. Reiterate BUY with TP of HK\$28.1 based on 17.4x FY21E P/E.

- China 3rd batch 5G BTS tender is in progress.** Based on our recent checks, despite delay of bidding announcement of China 3rd batch of 5G BTS tenders in 1H21, China 5G BTS deployment has already kicked off in two tranches: 1) 120k 2.6GHz by CM and 320k 3.5GHz/2.1GHz by CU/CT, and 2) 400k+ 700MHz by CM/CBN (2 years plan). We expect share allocation of 3.5GHz/2.6GHz/ 2.1GHz BTS will be similar to that of 4G/5G BTS deployed in each city, which is positive to ZTE's share gain as 5G deployment is expanding from Tier 1/2 cities to Tier 3/4 cities where ZTE has stronger presence. In addition, we believe the details of 700MHz 5G BTS deployment will release in 2H21E.
- Growing opportunities in domestic Gov./enterprise business.** Mgmt. expected significant room to grow in domestic government and enterprise markets with 50% CAGR in FY21-23E, given 1) stronger demand to accelerate digital transformation as a result of COVID-19, 2) growing needs for localization and 3) technology leadership backed by ZTE's ICT capabilities.
- Improving GPM driven by self-developed chips and operating efficiency.** GPM continued to recover to 35.4% in 1Q21 (vs. 31.6% FY20), thanks to adoption of self-developed chips in 2H20. ZTE stated that the size of its BTS is reduced by 30%, power consumption is reduced by 30%, performance is improved by 30%, and cost is optimized by 20-30%.
- Reiterate BUY with TP of HK\$28.1.** We maintain our TP of HK\$28.1 based on 17.4x FY21E P/E, in-line with 2-year historical forward P/E. Trading at 14.0x FY21E P/E (1-sd below 2-yr avg. P/E), the stock is attractive in view. We are positive on its 2H21E outlook given its share gain in China 3rd batch 5G BTS tender. Upcoming catalysts include China 5G BTS tender details and global share gain.

Earnings Summary

(YE 31 Dec)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (RMB mn)	90,737	101,451	116,995	129,070	140,524
YoY growth (%)	6.1	11.8	15.3	10.3	8.9
Net profit (RMB mn)	5,148	4,260	6,181	7,097	8,903
EPS (RMB)	1.22	0.92	1.34	1.54	1.93
YoY growth (%)	NA	-24.8	45.6	14.8	25.4
Consensus EPS (RMB)	NA	0.99	1.31	1.60	1.91
PE (x)	15.3	20.3	14.0	12.2	9.7
PB (x)	2.3	2.0	1.8	1.6	1.4
Yield (%)	0.8	0.8	1.1	1.3	1.6
ROE (%)	19.9	11.8	13.5	13.9	15.6
Net debt/total equity (%)	50.0	43.8	50.1	50.5	41.8

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price	HK\$ 28.1
(Previous TP)	HK\$28.1)
Up/Downside	+24.5%
Current Price	HK\$ 22.6

China Technology Sector

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Stock Data

Mkt. Cap. (HK\$ mn)	166,630
Avg. 3mths t/o (HK\$ mn)	174
52W High/Low (HK\$)	29.95/16.50
Total Issued Shares (mn)	755.5

Source: Bloomberg

Shareholding Structure

BlackRock	5.91%
Capital Group	5.08%
Schroders	4.93%

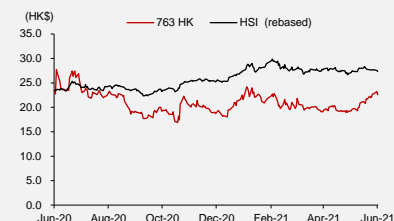
Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	21.0%	18.4%
3-mth	17.4%	18.2%
6-mth	24.1%	13.5%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

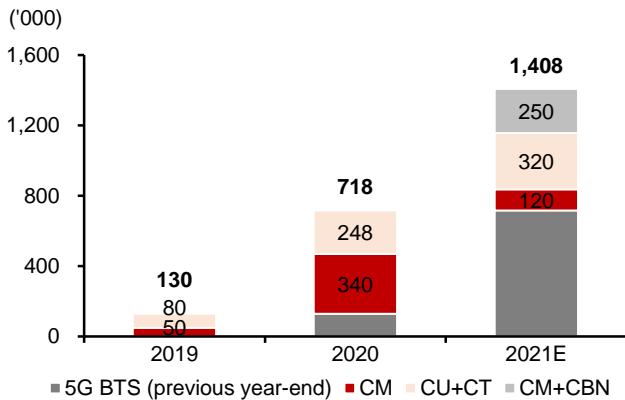
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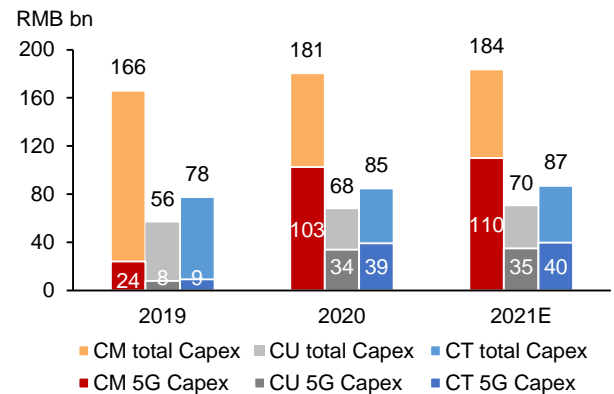
Focus Charts

Figure 1: 5G deployment status: 2020/21E 5G BTS new-add are 588k/690k (including 400k 700MHz)



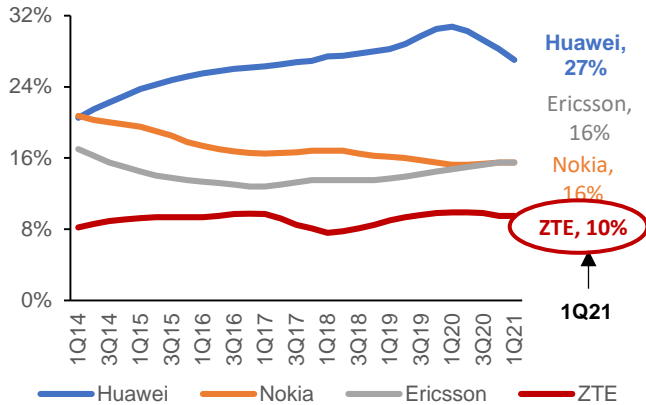
Source: Company filings, CMBIS estimates

Figure 2: 2021E Telco's Capex budget is similar to 2020 (China Mobile/China Unicom/China telecom)



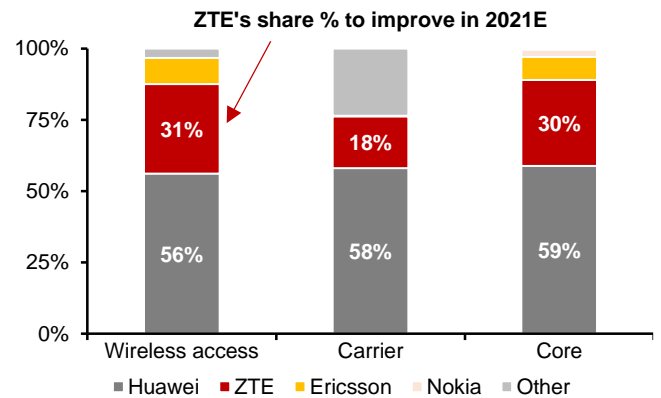
Source: Company filings, CMBIS estimates

Figure 3: Telecom equipment vendor market share (1Q14-1Q21): ZTE ranked as No. 4 globally



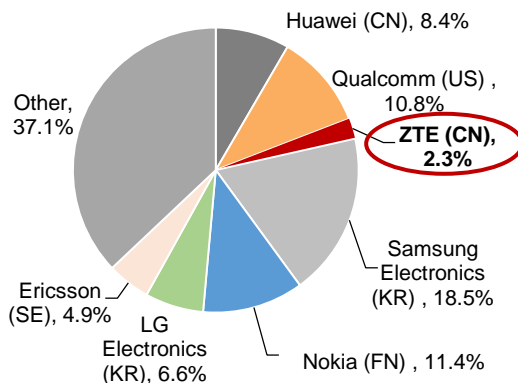
Source: Dell'Oro, CMBIS estimates

Figure 4: ZTE ranked as No.2 with 31% market share of China 5G BTS tender in 2020



Source: China mobile, China Unicom, China telecom, xinhuanet, C114, CMBIS estimates

Figure 5: 5G EP or US granted and active families multiplied by essentiality rate of 1,000 expert mapped patents



Source: Iplytics, CMBIS estimates

Figure 6: Huawei revealed licensing fees for its 5G standard-essential patents (SEPs)

Company	Announced date	Royalties Fee schedule
Huawei	2021/03	\$2.50 cap for smartphone makers
Nokia	2018	3 euro (\$3.58) cap per device
Ericsson	2018	\$2.50 to \$5 per device
Qualcomm	2017	2.275%/3.25% for 5G SEPs and 4%/5% for entire portfolio of patents for single-mode/multi-mode devices. Later the rate was cut from \$16.25 per phone to \$13.

Source: Bloomberg, CMBIS estimates

Assumptions

Figure 7: P&L forecast

RMB mn	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	90,737	101,451	116,995	129,070	140,524
...YoY	6.1%	11.8%	15.3%	10.3%	8.9%
Cost of sales	(57,008)	(69,379)	(77,348)	(84,986)	(92,101)
Gross profit	33,728	32,071	39,647	44,084	48,423
GPM (%)	37.2%	31.6%	33.9%	34.2%	34.5%
...YoY	19.8%	-4.9%	23.6%	11.2%	9.8%
SG&A	(12,642)	(12,574)	(14,507)	(16,134)	(17,706)
...% of rev	-13.9%	-12.4%	-12.4%	-12.5%	-12.6%
R&D	(12,548)	(14,797)	(17,081)	(18,457)	(19,673)
...% of rev	-13.8%	-14.6%	-14.6%	-14.3%	-14.0%
Operating profit	7,552	5,471	8,671	9,915	12,267
OPM (%)	8.3%	5.4%	7.4%	7.7%	8.7%
...YoY	-1334.1%	-27.6%	58.5%	14.3%	23.7%
Net profit	5,148	4,260	6,181	7,097	8,903
NPM (%)	5.7%	4.2%	5.3%	5.5%	6.3%
...YoY	-173.7%	-17.3%	45.1%	14.8%	25.4%

Source: Company data, CMBIS estimates

Figure 8: Revenue breakdown

RMB mn	FY19A	FY20A	FY21E	FY22E	FY23E
Carriers' network	66,584	74,018	85,824	94,098	101,469
...YoY	17%	11%	16%	10%	8%
China	47,260	52,051	61,606	65,999	68,299
...YoY	15%	10%	18%	7%	3%
Overseas	19,324	21,967	24,217	28,099	33,170
...YoY	21%	14%	10%	16%	18%
Consumer business	14,997	16,160	17,166	18,431	19,935
...YoY	-22%	8%	6%	7%	8%
Gov. and corp. business	9,155	11,272	14,006	16,541	19,120
...YoY	-1%	23%	24%	18%	16%
Total	90,737	101,451	116,995	129,070	140,524
...YoY	6.1%	11.8%	15.3%	10.3%	8.9%
Gross Margin					
Carriers' network	42.6%	33.8%	36.5%	36.8%	37.2%
Consumer business	17.9%	23.6%	24.0%	24.2%	24.4%
Gov. and corp. business	29.2%	28.8%	30.0%	30.2%	30.4%
Blended GPM	37.2%	31.6%	33.9%	34.2%	34.5%

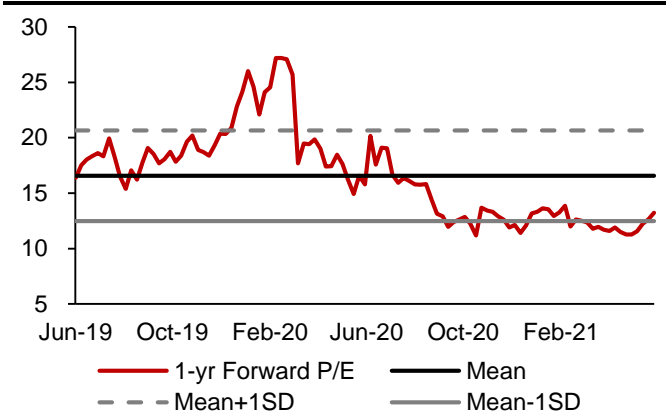
Source: Company data, CMBIS estimates

Valuation

Maintain BUY and maintain TP at HK\$28.1 (24.5% upside)

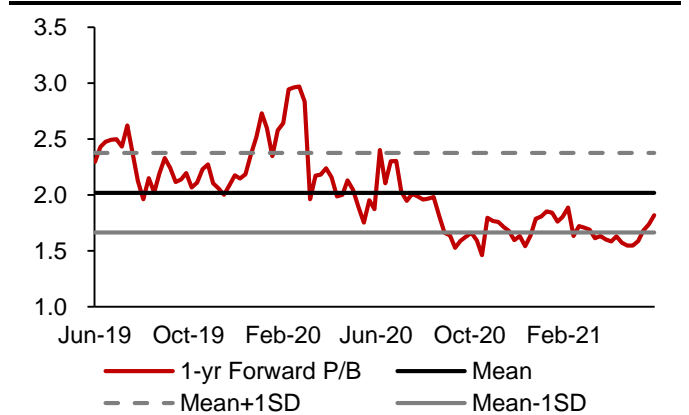
We maintain our TP at HK\$ 28.1 based on 17.4x FY21E P/E, in line with 2-year historical forward P/E. We estimate 20% EPS FY21-23E CAGR, backed by 10% revenue CAGR thanks to 1) healthy capex growth of China telco, 2) reaccelerated 5G deployment in China and resumption of network construction overseas, and 3) improving gross margin due to cost management and self-developed chips from Sanechip. As China 3rd batch 5G BTS tender is in progress, we think the Company outlook is positive.

Figure 9: 12M forward P/E band



Source: Company data, CMBIS estimates

Figure 10: 12M forward P/B band



Source: Company data, CMBIS estimates

Financial Summary

Income statement						Cash flow summary					
YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E	YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	90,737	101,451	116,995	129,070	140,524	Net profit	5,777	4,722	6,181	7,097	8,903
Cost of sales	(57,008)	(69,379)	(77,348)	(84,986)	(92,101)	Depreciation/amortization	3,062	3,565	4,258	4,844	5,428
Gross profit	33,728	32,071	39,647	44,084	48,423	Change in working capital	(4,177)	(1,965)	(589)	199	(1,290)
Selling exp	(7,869)	(7,579)	(8,658)	(9,422)	(10,118)	Others	2,785	3,911	(3,887)	(80)	(914)
Admin exp	(4,773)	(4,995)	(5,850)	(6,712)	(7,588)	Net cash from operating	7,447	10,233	5,962	12,060	12,127
R&D exp	(12,548)	(14,797)	(17,081)	(18,457)	(19,673)	Capex	6,551	6,472	8,146	8,282	8,530
Finance costs	(966)	(421)	(723)	(610)	99	Other	(12,574)	(13,554)	(14,293)	(15,064)	(15,560)
Other operating exp.	1,696	1,573	1,755	1,936	2,108	Net cash from investing	(6,023)	(7,082)	(6,146)	(6,782)	(7,030)
Operating profit	7,552	5,471	8,671	9,915	12,267	Net borrowings	9,019	9,019	15,147	6,443	(12,092)
Other non-oper exp.	(391)	(407)	(936)	(1,033)	(1,124)	Dividend paid	2,640	2,640	2,640	3,506	3,260
Pre-tax profit	7,162	5,064	7,736	8,883	11,143	Other	(5,938)	(5,938)	(5,280)	(7,011)	(6,521)
Income tax expense	(1,385)	(342)	(1,160)	(1,332)	(1,671)	Net cash from financing	5,722	5,722	12,506	2,938	(15,353)
Minority interests	(280)	(446)	(395)	(453)	(568)	Net change in cash	7,372	9,099	12,322	8,216	(10,255)
Perpetual capital instrument	(349)	(16)	-	-	-	Cash at beginning of the year	21,134	21,134	35,660	47,982	56,198
Net profit to shareholders	5,148	4,260	6,181	7,097	8,903	Exchange difference	227	227	-	-	-
						Cash at the end of the year	28,506	30,233	47,982	56,198	45,943

Balance sheet						Key ratios					
YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E	YE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Current assets	102,567	106,977	130,980	138,414	136,959	Revenue mix					
Cash & equivalents	33,309	35,660	47,982	56,198	45,943	Carrier business	66,584	74,018	85,824	94,098	101,469
Account receivables	19,778	15,891	23,937	19,086	26,987	Consumer business	14,997	16,160	17,166	18,431	19,935
Inventory	27,689	33,689	35,131	38,623	39,446	Gov. and enterprise	9,155	11,272	14,006	16,541	19,120
Prepayment	1,023	1,152	1,152	1,152	1,152	Growth (%)					
Other current assets	20,768	20,585	22,777	23,355	23,430	Revenue	6.1	11.8	15.3	10.3	8.9
Non-current assets	38,635	43,658	46,462	48,823	51,659	Gross profit	19.8	(4.9)	23.6	11.2	9.8
PPE	9,383	11,914	13,757	15,128	16,214	Operating profit	(1,334.1)	(27.6)	58.5	14.3	23.7
Intangible assets	7,719	9,367	10,802	11,936	12,849	Net profit	(173.7)	(17.3)	45.1	14.8	25.4
Other non-current assets	21,533	22,376	21,903	21,759	22,596	Profit & loss ratio (%)					
Total assets	141,202	150,635	177,442	187,237	188,617	Gross margin	37.2	31.6	33.9	34.2	34.5
Current liabilities	86,371	74,395	86,672	86,801	88,988	Operating margin	8.3	5.4	7.4	7.7	8.7
ST borrowings	27,258	12,664	18,101	20,414	16,073	Net profit margin	5.7	4.2	5.3	5.5	6.3
Account payables	18,356	17,152	23,558	21,172	27,302	Balance sheet ratio					
Tax payable	889	878	878	878	878	Gearing ratio (%)	50	44	50	50	42
Other current liabilities	39,868	43,701	44,135	44,337	44,734	Current ratio (x)	1.2	1.4	1.5	1.6	1.5
Non-current liabilities	16,877	30,117	39,827	43,957	36,206	Receivable turnover days	83	64	62	61	60
LT borrowings	10,045	22,614	32,324	36,454	28,703	Inventory turnover days	106	110	107	104	101
Deferred income	645	718	718	718	718	Payable turnover days	121	93	96	96	96
Other non-current liabilities	6,187	6,785	6,785	6,785	6,785	Profitability (%)					
Total liabilities	103,248	104,512	126,499	130,758	125,193	ROE	19.9	11.8	13.5	13.9	15.6
Shareholders' equity						ROA	3.6	2.8	3.5	3.8	4.7
Share capital	4,228	4,613	4,613	4,613	4,613	Per share data (RMB)					
Reserve	12,144	23,276	23,276	23,276	23,276	EPS (RMB)	1.22	0.92	1.34	1.54	1.93
Minority interest	2,875	2,826	2,826	2,826	2,826	DPS (RMB)	0.20	0.20	0.29	0.34	0.42
Total equity	37,954	46,123	50,944	56,479	63,424	BVPS (RMB)	8.30	9.39	10.43	11.63	13.14
Total liabilities and equity	141,202	150,635	177,442	187,237	188,617						

Source: Company data, CMBIS estimates

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